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No. 89-593

In the Supreme Court of the United States

OCTOBER TERM, 1989

LIBERTY MUTUAL INSURANCE COMPANY, ET AL.,
PETITIONERS

v.

COMMISSIONER OF REVENUE OF MASSACHUSETTS

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME JUDICIAL COURT OF MASSACHUSETTS

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

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QUESTIONS PRESENTED

1. Whether the inclusion of interest on obligations of the United States in the measure of the tax imposed on domestic insurance companies by Mass. Gen. L. ch. 63, § 22A (1978) for the years 1971 through 1977 violated the Constitution of the United States or Rev. Stat. § 3701 (1878) (31 U.S.C. 742).

2. Whether the inclusion of interest on obligations issued by Massachusetts governmental entities and declared to be exempt from taxation under Massachusetts laws, in the measure of the tax imposed on domestic insurance companies by Mass. Gen. L. ch. 63, § 22A (1978) for the years 1971 through 1977 violated the Contracts Clause (Art. I, § 10, Cl. 1) of the Constitution of the United States.

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BRIEF FOR THE UNITED STATES AS AMICUS CURIAE

This brief is submitted in response to the Court's order inviting the Solicitor General to express the views of the United States.

OPINIONS BELOW

The opinion of the Supreme Judicial Court of Massachusetts (Pet. App. A1-A11) is reported at 405 Mass. 352, 541 N.E.2d 566. The opinion of the Massachusetts Appellate Tax Board (Pet. App. A12-A25) is unreported.

JURISDICTION

The judgment of the Supreme Judicial Court of Massachusetts (Pet. App. A43) was entered on July 11, 1989. The petition for a writ of certiorari was filed on October 9, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).

STATEMENT

Petitioners are insurance companies organized under the laws of Massachusetts, with their principal place of business in that Commonwealth. They were therefore subject to the tax imposed by Mass. Gen. L. ch. 63, § 22A (1978), during the years 1971 through 1977.[1] Each petitioner filed returns includ-

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[1] Until January 1, 1982, Mass. Gen. L. ch. 63, § 22A (1978) provided:

> *Domestic Insurance Companies to Pay Annual Excise.* Every domestic insurance company coming within the scope of the definition of a domestic company in section one of chapter one hundred and seventy-five shall annually pay, as part of its excise imposed under this chapter, an amount equal to one per cent of its total gross investment income earned during the preceding calendar year, as reported in its annual statement for said year filed with the commissioner of insurance and as shown in Exhibit 3 of said statement for a life insurance company or in Item 10, Column 8, Part I of the Underwriting and Investment Exhibit for any other domestic insurance company.

At the same time, Section 28 provided in relevant part:

> *Payment of Tax.* * * *. Liability for the taxes imposed by sections twenty to twenty-three, inclusive, * * * shall be incurred by reason of the transaction of business at any time within the calendar year preceding that in which the return is required to be filed.

Effective January 1, 1982, Section 22A contains an exception for life insurance companies. Petitioners are not life insurance companies.

ing the information required for assessment of the tax imposed by Section 22A for each of the years 1971 through 1977. On those returns, each included in gross investment income interest earned from bonds of the United States, Treasury Notes, and other obligations of the United States, and also interest from bonds that had been issued by Massachusetts governmental entities and that were exempted from taxation under Massachusetts law. Each paid the taxes resulting from inclusion of those interest items. Each petitioner thereafter made timely applications to the Commissioner of Revenue to abate the excise taxes for the years 1971 through 1977. Upon the Commissioner's refusal, the petitioners appealed to the Appellate Tax Board. Pet. App. A3-A4, A12-A14.

In the Appellate Tax Board proceeding, the parties submitted a Statement of Agreed Facts covering returns for each petitioner's 1975 taxable year, which they agreed was a typical year for the issues raised. Petitioners asserted that the inclusion of interest from federal obligations in gross investment income taxable under Section 22A was unconstitutional and in conflict with Rev. Stat. § 3701 (1878) (31 U.S.C. 742 [2]), and that inclusion of interest from obligations issued by certain Massachusetts governmental entities conflicted with the exemption of those obli-

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[2] As this Court pointed out in *American Bank & Trust Co. v. Dallas County*, 463 U.S. 855, 859 n. 1 (1983), Title 31 of the United States Code was not enacted until 1982, when it was reformulated without substantive change, and Rev. Stat. § 3701 (1878) was replaced by 31 U.S.C. 3124(a) (1982). Because the state taxes here at issue were for the years 1971 through 1977, Rev. Stat. § 3701 (1878), as amended in 1959, governs this case.

gations from taxation by the terms of the enabling Acts of those entities, and thus violated the Contracts Clause (Art. I, § 10, Cl. 1) of the Constitution of the United States. Pet. App. A14-A15.

The Appellate Tax Board denied both claims. It rejected petitioners' reliance on *Northwestern Mutual Life Ins. Co.* v. *Wisconsin*, 275 U.S. 136 (1927), as governing authority, pointing out that this Court before and since that decision has held that the Constitution and Rev. Stat. § 3701 (1878) do not prohibit the imposition of nondiscriminatory state franchise taxes measured by assets including federal obligations, or by income including interest from federal obligations. It added that the Supreme Judicial Court of Massachusetts had held that the tax imposed by Section 22A is a franchise tax, and that inclusion of interest from federal obligations in the measure of the tax imposed by Section 22A had been upheld by that court in *Commissioner of Revenue* v. *Massachusetts Mutual Life Ins. Co.*, 384 Mass. 607, 428 N.E.2d 297 (1981), which is set forth at Pet. App. A26-A42. Pet. App. A15-A18.

On similar grounds, the Appellate Tax Board rejected the claim that inclusion of interest from tax-exempt bonds of state agencies in the measure of the tax imposed by Section 22A violated the Contracts Clause of the Constitution, invoking the decision of the Supreme Judicial Court in *Massachusetts Mutual Life*, and this Court's decision in *Pacific Co.* v. *Johnson*, 285 U.S. 480 (1932). Pet. App. A19-A21.

On appeal from the Board's decision, the Supreme Judicial Court transferred the cases to itself on its own motion, and affirmed. It reviewed and reaffirmed its earlier decision in *Massachusetts Mutual Life*, pointing out that "[t]he tax imposed by § 22A is a 'nondiscriminatory franchise tax or other non-

property tax' permitted by [Rev. Stat. § 3701 (1878)]." Pet. App. A5. It rejected the authority of *Northwestern Mutual Life Ins. Co.* v. *Wisconsin*, 275 U.S. 136 (1927), on which petitioners relied and continue to rely, in favor of the later decision of this Court in *Werner Mach. Co.* v. *Director, Div. of Taxation*, 350 U.S. 492 (1956) and the whole course of this Court's decisions on intergovernmental immunities since the 1930's, noting the concurrence of other state courts and the fact that the state court decisions invoked by petitioners did not compel the opposite conclusion. Pet. App. A6-A7 & n. 7. The court also rejected petitioners' Contracts Clause claim, pointing out that it had held in *Massachusetts Mutual Life* that although the enabling Acts of certain state authorities exempted bonds issued by those authorities from taxation on income or property, those obligations were not exempted from forming part of the base on which an excise tax may be levied for the privilege of doing business in Massachusetts. Pet. App. A8-A9.

DISCUSSION

Petitioners invoke both the Constitution itself and the terms of Rev. Stat. § 3701 (1878) in support of their claim that interest on obligations of the United States and interest on statutorily tax-exempt obligations of Massachusetts governmental authorities may not be included in the measure of the tax imposed on domestic insurance companies by Section 22A of Chapter 63 of the Massachusetts General Laws (1978). We believe that neither claim has substance.

1. This Court in *Weston* v. *Charleston*, 27 U.S. (2 Pet.) 449 (1829), held that a tax on specified forms of property in the City of Charleston could not be imposed upon obligations of the United States,

since the tax would impinge upon the constitutional authority of the United States to borrow money, and would constitute "a burden on the operation of government." *Id.* at 468. That decision was followed in two cases holding that a New York tax upon the capital of state banks could be enforced only insofar as the amount on which the tax was computed was reduced by the value of United States obligations held by the banks. *Bank of Commerce* v. *New York City*, 67 U.S. (2 Black) 620 (1863); *Bank Tax Case*, 69 U.S. (2 Wall.) 200 (1865).

From 1862 through 1870, Congress passed seven statutes authorizing the Secretary of the Treasury to borrow large amounts on the credit of the United States. In slightly variant terms, each statute provided that obligations of the United States generally, or the obligations authorized by that statute, should be exempt from taxation by state or local authority.[3] The statutory exemption was thereafter made general, and permanent, by Section 3701 of the Revised Statutes (1878):

> All stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority.

Meanwhile, this Court had held that certain taxing statutes of Connecticut and Massachusetts were franchise taxes, *i.e.* imposed for the privilege of doing business in the State, and that such taxes were not on, but could be measured by, corporate assets, including obligations of the United States. *Society for Savings* v. *Coite*, 73 U.S. (6 Wall.) 594 (1868);

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[3] The statutes are listed, and the exempting provisions quoted, in *Smith* v. *Davis*, 323 U.S. 111, 117 n. 7 (1944).

Provident Institution v. *Massachusetts*, 73 U.S. (6 Wall.) 611 (1868); *Hamilton Co.* v. *Massachusetts*, 73 U.S. (6 Wall.) 632 (1868). Significantly, the 1862 Massachusetts tax held to be a franchise tax in *Provident Institution* v. *Massachusetts*, *supra*, was the origin of the present excise tax on domestic insurance companies, although the measure of the tax has been amended from time to time. See *Commissioner of Insurance* v. *Commonwealth Mutual Liability Ins. Co.*, 308 Mass. 385, 386, 388, 32 N.E.2d 231, 233 (1941).

Since the 1868 decisions, state franchise taxes on corporations, measured either by the property of the corporation or by its income, have consistently been permitted to include in their taxable measure obligations of the United States or income from such obligations or other exempt sources. *Home Insurance Co.* v. *New York*, 134 U.S. 594 (1890); *Educational Films Corp.* v. *Ward*, 282 U.S. 379 (1931); *Tradesmens Nat'l Bank* v. *Oklahoma Tax Commission*, 309 U.S. 560 (1940); *Werner Mach. Co.* v. *Director, Div. of Taxation*, 350 U.S. 492 (1956).[4] In the reciprocal situation, this Court upheld a federal tax on doing business in corporate form measured by net income that included interest on municipal bonds. *Flint* v. *Stone Tracy Co.*, 220 U.S. 107 (1911). Although this Court has recently referred to the distinction between a tax on, and a tax measured by, federal obligations as "formal but economically

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[4] *Macallen Co.* v. *Massachusetts*, 279 U.S. 620 (1929), once thought to cast doubt on these decisions, and invoked by petitioners at Pet. 7, 22, 25, has been said by this Court to be without precedential value. *Phillips Chemical Co.* v. *Dumas Ind. School Dist.*, 361 U.S. 376, 382 (1960); *United States* v. *City of Detroit*, 355 U.S. 466, 472 n. 2 (1958).

meaningless," it at the same time quoted from an earlier decision stating that the distinction is "firmly embedded in the law." *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855, 858 (1983) (quoting *Society for Savings* v. *Bowers*, 349 U.S. 143, 148 (1955)).

In any event, however the distinction may be described, Congress perpetuated it by the Act of Sept. 22, 1959, Pub. L. No. 86-346, § 105(a), 73 Stat. 622, when it amended Rev. Stat. § 3701 (1878) by adding a second sentence, as follows:

> This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes.

There can be no substantial doubt that Section 22A is a "nondiscriminatory franchise tax[] * * * imposed on corporations." It is clearly nondiscriminatory, and petitioners do not contend otherwise. Cf. *Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392 (1983). While, as this Court stated in *Werner Mach. Co.* v. *Director, Div. of Taxation*, 350 U.S. at 493, the characterization of the court below is not conclusive, this Court in *Provident Institution* v. *Massachusetts*, *supra*, found the predecessor of the present statute to be a franchise tax. Section 28 of Chapter 63, set forth in footnote 1, *supra*, provides that "[l]iability * * * shall be incurred by reason of the transaction of business". And the Massachusetts Supreme Judicial Court has given substantive meaning to the fact that the tax is a franchise tax by hold-

ing that after a corporation has been enjoined from doing business, it is no longer subject to the excise imposed by Sections 22-29 of Chapter 63 of the General Laws of Massachusetts. *Commissioner of Insurance* v. *Commonwealth Mutual Liability Ins. Co., supra.*

Against this authority, petitioners invoke this Court's decision in *Northwestern Mutual Ins. Co.* v. *Wisconsin*, 275 U.S. 136 (1927), which they state (Pet. 6) has never been overruled or impaired. The Court in that case held that a three percent license fee for transacting business in the state (*i.e.*, a franchise tax), measured by gross income, was unconstitutional insofar as interest on bonds of the United States was included. The Court invoked *Gillespie* v. *Oklahoma*, 257 U.S. 501 (1922), and stressed a difference between gross income and net income, although at the time, when the decision in *Pollock* v. *Farmers Loan & Trust Co.*, 157 U.S. 429 (1895), as well as the reciprocal position, was unquestioned, a state tax on net income from government bonds was no less unconstitutional than a tax on gross income from the same source. The Court, in any event, did not hold that the tax was not a franchise tax, but only that the measure offended the Constitution insofar as it included interest from obligations of the United States.

Even if the *Northwestern* decision retained, until 1959, the authority attributed to it by petitioners, there is no reason to believe that it was not legislatively overruled by the amendment to Rev. Stat. § 3701 (1878), which explicitly excepted nondiscriminatory franchise taxes from the immunities ordered by that statute. Nor is there any basis for petitioners' suggestion that a tax measured by gross income

can not be a franchise tax. See *General Motors Corp.* v. *Washington*, 377 U.S. 436 (1964) (upholding state franchise tax based on "gross wholesale sales of motor vehicles, parts and accessories delivered in the State" against constitutional challenges based on Commerce and Due Process Clauses); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977) (upholding state franchise tax based on gross income against Commerce Clause challenge). And amended Rev. Stat. § 3701 (1878) makes no distinction between taxes measured by gross or net income; it simply permits nondiscriminatory franchise taxes.

It seems clear, in any event, that although it may not have been explicitly overruled, the *Northwestern* decision did not long retain authority. *Gillespie* v. *Oklahoma*, *supra*, which it invoked as authority, was overruled by *Helvering* v. *Mountain Producers Corp.*, 303 U.S. 367 (1938). *Mountain Producers* also overruled *Burnet* v. *Coronado Oil & Gas Co.*, 285 U.S. 393 (1932), which had relied on *Northwestern*. Indeed, a number of the cases that succeeded *Northwestern* and invoked its authority were later explicitly overruled.[5]

More importantly, as noted in *United States* v. *New Mexico*, 455 U.S. 720, 731 (1982), the Court, with the decision in *James* v. *Dravo Contracting Co.*, 302 U.S. 134 (1937), "marked a major change in course". The new course, set forth in *United States* v. *New Mexico* (455 U.S. at 733-738), is summarized in *South Carolina* v. *Baker*, 108 S. Ct. 1355, 1366 (1988):

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[5] *E.g.*, *Long* v. *Rockwood*, 277 U.S. 142, 148 (1928), overruled in *Fox Film Corp.* v. *Doyal*, 286 U.S. 123 (1932); *Panhandle Oil Co.* v. *Knox*, 277 U.S. 218, 221 (1928), overruled in *Alabama* v. *King & Boozer*, 314 U.S. 1 (1941).

> In sum, then, under current intergovernmental tax immunity doctrine the State can never tax the United States directly but can tax any private parties with whom it does business, even though the financial burden falls on the United States, as long as the tax does not discriminate against the United States or those with whom it deals. See *Washington* [v. *United States*], 460 U.S. [536,] 540 [(1983)]; [*United States* v.] *County of Fresno*, 429 U.S. [452,] 460-463 [1977]; [*United States* v.] *City of Detroit*, 355 U.S. [466,] 473 [1958]; *Oklahoma Tax Comm'n* [v. *Texas Co.*], 336 U.S. [342,] 359-364 [1949]. A tax is considered to be directly on the Federal Government only "when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities." *New Mexico*, *supra*, 455 U.S. at 735.

Accordingly, under current doctrine it is clear that the Constitution does not itself immunize interest on obligations of the United States held in private hands from taxation by the States, and *a fortiori* does not immunize such interest from being included in the measure of a franchise tax. Of course, Congress may establish and define immunity for federal instrumentalities (*Carson* v. *Roane-Anderson Co.*, 342 U.S. 232 (1952); *First Agricultural Nat'l Bank* v. *State Tax Commission*, 392 U.S. 339 (1968)), as it has done in Rev. Stat. § 3701 (1878), but there is no constitutional reason to diminish the scope of the exception for nondiscriminatory franchise taxes that Congress has explicitly provided.

The court below correctly stated (Pet. App. A7 n. 7) that there is no conflict in the decisions of authoritative state courts on the intergovernmental immunity question. *First Federal Savings & Loan Ass'n* v. *Commonwealth*, 515 Pa. 369, 528 A.2d 942 (1987) and *Commonwealth Securities and Investment Inc.* v. *Commonwealth*, 511 Pa. 376, 514 A.2d 1373 (1986) (cited at Pet. 17, 18, 21) involved purely state questions under state statutes. Cf. *Continental Bank* v. *Arizona Department of Revenue*, 131 Ariz. 6, 638 P.2d 228 (1981) (cited at Pet. 6, 13, (state question under state constitution)). *Dale Nat'l Bank* v. *Commonwealth*, 502 Pa. 170, 465 A.2d 965 (1983) (cited at Pet. 17) followed *American Bank & Trust Co.* v. *Dallas County*, 463 U.S. 855 (1983) with respect to a property tax. In *Federal Products Corp.* v. *Norberg*, 429 A.2d 447 (R.I. 1981) (cited at Pet. 17) although the interest from federal obligations was not included in income taxed under the Rhode Island statute, those obligations were employed in computing that part of corporate income that was apportioned to Rhode Island, and thus the case fell within the specific prohibition of Rev. Stat. § 3701 (1878), as amended in 1959.[6] The first question presented by petitioners accordingly does not merit further review.

2. Petitioners' gross investment income during the years here at issue also included interest on bonds of Massachusetts governmental entities authorized and issued under state statutes providing that such bonds should be exempt from taxation. Petitioners assert that including the interest on such bonds in the measure of the tax imposed by Section 22A impairs

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[6] None of the other state decisions cited by petitioners is relevant to the issues raised in the petition.

the obligation of contract in violation of Article I, Section 10, Clause 1 of the Constitution of the United States. The Appellate Tax Board (Pet. App. A19-A21) and the Supreme Judicial Court (Pet. App. A9) correctly rejected that claim.

As this Court recently pointed out (*United States* v. *Wells Fargo Bank*, 108 S. Ct. 1179, 1182 (1988)):

> [A]n exemption of property from all taxation had an understood meaning: the property was exempt from *direct* taxation, but certain privileges of ownership such as the right to transfer the property could be taxed. Underlying this doctrine is the distinction between an excise tax, which is levied upon the use or transfer of property even though it might be measured by the property's value, and a tax levied upon the property itself. The former has historically been permitted even where the latter has been constitutionally or statutorily forbidden.

Accordingly, this Court, as long ago as *Orr* v. *Gilman*, 183 U.S. 278 (1902), held that a state inheritance tax applicable to state bonds issued with statutory provisions for exemption from taxation did not impair the obligation of contract in violation of the Constitution. The claim asserted by petitioners in this case was expressly rejected by this Court in *Pacific Co.* v. *Johnson*, 285 U.S. 480 (1932). In that case, the Court held that income from bonds issued by California municipalities and declared to be exempt from taxation by the state constitution, could nevertheless be included in the measure of a corporate franchise tax subsequently imposed by California without impairing the obligation of contract in violation of the Constitution. No case has since ques-

tioned the authority of that decision, which marked the Court's turning away from *Macallen Co.* v. *Massachusetts*, 279 U.S. 620 (1929), and other cases invoked by petitioners. See *Tradesmens Nat'l Bank* v. *Oklahoma Tax Commission*, 309 U.S. 560, 565-566 (1940); *United States* v. *City of Detroit*, 355 U.S. 466, 471 (1958).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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